

SECOND DIVISION

[G.R. No. 196596, November 09, 2016]

**COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. DE LA SALLE UNIVERSITY, INC.,
RESPONDENT.**

[G.R. No. 198841]

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DECISION

BRION, J.:

Before the Court are consolidated petitions for review on *certiorari*:^[1]

1. **G.R. No. 196596** filed by the Commissioner of Internal Revenue (*Commissioner*) to assail the December 10, 2010 decision and March 29, 2011 resolution of the Court of Tax Appeals (*CTA*) in *En Banc* Case No. 622;^[2]
2. **G.R. No. 198841** filed by De La Salle University, Inc. (*DLSU*) to assail the June 8, 2011 decision and October 4, 2011 resolution in *CTA En Banc* Case No. 671;^[3] and
3. **G.R. No. 198941** filed by the Commissioner to assail the June 8, 2011 decision and October 4, 2011 resolution in *CTA En Banc* Case No. 671.^[4]

G.R. Nos. 196596, 198841 and 198941 all originated from CTA Special First Division (*CTA Division*) **Case No. 7303**. G.R. No. 196596 stemmed from **CTA En Banc Case No. 622** filed by the Commissioner to challenge CTA Case No. 7303. G.R. No. 198841 and 198941 both stemmed from **CTA En Banc Case No. 671** filed by DLSU to also challenge CTA Case No. 7303.

The Factual Antecedents

Sometime in 2004, the Bureau of Internal Revenue (*BIR*) issued to DLSU Letter of Authority (LOA) No. 2794 authorizing its revenue officers to examine the latter's books of accounts and other accounting records for all internal revenue taxes for the period *Fiscal Year Ending 2003 and Unverified Prior Years*.^[5]

On May 19, 2004, BIR issued a *Preliminary Assessment Notice* to DLSU.^[6]

Subsequently on August 18, 2004, the BIR through a *Formal Letter of Demand* assessed DLSU the following deficiency taxes: (1) *income tax* on rental earnings from restaurants/canteens and bookstores operating within the campus; (2) *value-added tax (VAT)* on business income; and (3) *documentary stamp tax (DST)* on loans and lease contracts. The BIR demanded the payment of **P17,303,001.12**, inclusive of surcharge, interest and penalty for **taxable years 2001, 2002 and 2003**.^[7]

DLSU protested the assessment. The Commissioner failed to act on the protest; thus, DLSU filed on August 3, 2005 a petition for review with the CTA Division.^[8]

DLSU, a *non-stock, non-profit educational institution*, principally anchored its petition on **Article XIV, Section 4 (3)** of the Constitution, which reads:

- (3) All revenues and assets of non-stock, non-profit educational institutions used actually, directly, and exclusively for educational purposes shall be exempt from taxes and duties. xxx.

On January 5, 2010, the CTA Division partially granted DLSU's petition for review. The dispositive portion of the decision reads:

WHEREFORE, the Petition for Review is **PARTIALLY GRANTED**. The DST assessment on the loan transactions of [DLSU] in the amount of P1,1681,774.00 is hereby **CANCELLED**. However, [DLSU] is **ORDERED TO PAY** deficiency income tax, VAT and DST on its lease contracts, plus 25% surcharge for the fiscal years 2001, 2002 and 2003 in the total amount of **P18,421,363.53...xxx**.

In addition, [DLSU] is hereby held liable to pay 20% delinquency interest on the total amount due computed from September 30, 2004 until full payment thereof pursuant to Section 249(C)(3) of the [National Internal Revenue Code]. Further, the compromise penalties imposed by [the Commissioner] were excluded, there being no compromise agreement between the parties.

SO ORDERED.^[9]

Both the Commissioner and DLSU moved for the reconsideration of the January 5, 2010 decision.^[10] On April 6, 2010, the CTA Division denied the Commissioner's motion for reconsideration while it held in abeyance the resolution on DLSU's motion for

reconsideration.^[11]

On May 13, 2010, the Commissioner appealed to the CTA *En Banc* (CTA *En Banc* Case No. 622) arguing that DLSU's use of its revenues and assets for non-educational or commercial purposes removed these items from the exemption coverage under the Constitution.^[12]

On May 18, 2010, DLSU formally offered to the CTA Division supplemental pieces of documentary evidence to prove that its rental income was used actually, directly and exclusively for educational purposes.^[13] *The Commissioner did not promptly object to the formal offer of supplemental evidence despite notice.*^[14]

On July 29, 2010, the CTA Division, in view of the supplemental evidence submitted, reduced the amount of DLSU's tax deficiencies. The dispositive portion of the *amended decision* reads:

WHEREFORE, [DLSU]'s Motion for Partial Reconsideration is hereby **PARTIALLY GRANTED**. [DLSU] is hereby **ORDERED TO PAY** for deficiency income tax, VAT and DST plus 25% surcharge for the fiscal years 2001, 2002 and 2003 in the total adjusted amount of **P5,506,456.71**...xxx.

In addition, [DLSU] is hereby held liable to pay 20% per annum deficiency interest on the...basic deficiency taxes...until full payment thereof pursuant to Section 249(B) of the [National Internal Revenue Code]...xxx.

Further, [DLSU] is hereby held liable to pay 20% per annum delinquency interest on the deficiency taxes, surcharge and deficiency interest which have accrued...from September 30, 2004 until fully paid.^[15]

Consequently, the Commissioner supplemented its petition with the CTA *En Banc* and argued that the CTA Division erred in admitting DLSU's additional evidence.^[16]

Dissatisfied with the partial reduction of its tax liabilities, DLSU filed a *separate* petition for review with the CTA *En Banc* (CTA *En Banc* Case No. 671) on the following grounds: (1) the entire assessment should have been cancelled because it was based on an invalid LOA; (2) assuming the LOA was valid, the CTA Division should still have cancelled the *entire* assessment because DLSU submitted evidence similar to those submitted by Ateneo De Manila University (*Ateneo*) in a *separate* case where the CTA cancelled Ateneo's tax assessment;^[17] and (3) the CTA Division erred in finding that a *portion* of DLSU's rental income was not proved to have been used actually, directly and exclusively for educational purposes.^[18]

The CTA *En Banc* Rulings

CTA *En Banc* Case No. 622

The CTA *En Banc* dismissed the Commissioner's petition for review and sustained the findings of the CTA Division.^[19]

Tax on rental income

Relying on the findings of the court-commissioned Independent Certified Public Accountant (Independent CPA), the CTA *En Banc* found that DLSU was able to prove that a *portion* of the assessed rental income was used actually, directly and exclusively for educational purposes; hence, exempt from tax.^[20] The CTA *En Banc* was satisfied with DLSU's supporting evidence confirming that part of its rental income had indeed been used to pay the loan it obtained to build the university's Physical Education - *Sports Complex*.^[21]

Parenthetically, DLSU's unsubstantiated claim for exemption, *i.e.*, the part of its income that was not shown by supporting documents to have been actually, directly and exclusively used for educational purposes, must be subjected to income tax and VAT.^[22]

DST on loan and mortgage transactions

Contrary to the Commissioner's contention, DLSU *proved its remittance of the DST due on its loan and mortgage documents*.^[23] The CTA *En Banc* found that DLSU's DST payments had been remitted to the BIR, evidenced by the stamp on the documents made by a DST imprinting machine, which is allowed under Section 200 (D) of the National Internal Revenue Code (*Tax Code*)^[24] and Section 2 of Revenue Regulations (RR) No. 15-2001.^[25]

Admissibility of DLSU's supplemental evidence

The CTA *En Banc* held that the supplemental pieces of documentary evidence were admissible even if DLSU formally offered them only when it moved for reconsideration of the CTA Division's original decision. Notably, the law creating the CTA provides that proceedings before it shall not be governed strictly by the technical rules of evidence.^[26]

The Commissioner moved but failed to obtain a reconsideration of the CTA *En Banc*'s December 10, 2010 decision.^[27] Thus, she came to this court for relief through a petition for review on *certiorari* (G.R. No. 196596).

CTA *En Banc* Case No. 671

The CTA *En Banc* partially granted DLSU's petition for review and further reduced its tax liabilities to **P2,554,825.47** inclusive of surcharge.^[28]

On the validity of the Letter of Authority

The issue of the LOA's validity was raised during trial;^[29] hence, the issue was deemed properly submitted for decision and reviewable on appeal.

Citing jurisprudence, the CTA *En Banc* held that a LOA should cover only one taxable period and that the practice of issuing a LOA covering audit of *unverified prior years* is prohibited.^[30] The prohibition is consistent with Revenue Memorandum Order (RMO) No. 43-90, which provides that if the audit includes more than one taxable period, the other periods or years shall be specifically indicated in the LOA.^[31]

In the present case, the LOA issued to DLSU is for *Fiscal Year Ending 2003 and Unverified Prior Years*. Hence, the assessments for deficiency income tax, VAT and DST for taxable years **2001 and 2002** are **void**, but the assessment for taxable year **2003** is **valid**.^[32]

On the applicability of the Ateneo case

The CTA *En Banc* held that the *Ateneo* case is not a valid precedent because it involved different parties, factual settings, bases of assessments, sets of evidence, and defenses.^[33]

On the CTA Division's appreciation of the evidence

The CTA *En Banc* affirmed the CTA Division's appreciation of DLSU's evidence. It held that while DLSU successfully proved that a portion of its rental income was transmitted and used to pay the loan obtained to fund the construction of the Sports Complex, the rental income from *other* sources were not shown to have been actually, directly and exclusively used for educational purposes.^[34]

Not pleased with the CTA *En Banc*'s ruling, both DLSU (G.R. No. 198841) and the Commissioner (G.R. No. 198941) came to this Court for relief.

The Consolidated Petitions

G.R. No. 196596

The Commissioner submits the following arguments:

First, DLSU's rental income is taxable regardless of how such income is derived, used or disposed of.^[35] DLSU's operations of canteens and bookstores within its campus even though exclusively serving the university community do not negate income tax liability.^[36]

The Commissioner contends that Article XIV, Section 4 (3) of the Constitution must be harmonized with Section 30 (H) of the Tax Code, which states among others, that the income of whatever kind and character of [a non-stock and non-profit educational institution] from any of [its] properties, real or personal, or from any of [its] activities conducted for profit *regardless of the disposition made of such income*, shall be subject to tax imposed by this Code.^[37]

The Commissioner argues that the CTA *En Banc* misread and misapplied the case of **Commissioner of Internal Revenue v. YMCA**^[38] to support its conclusion that revenues however generated are covered by the constitutional exemption, provided that, the revenues will be used for educational purposes or will be held in reserve for such purposes.^[39]

On the contrary, the Commissioner posits that a tax-exempt organization like DLSU is exempt only from property tax but not from income tax on the rentals earned from property.^[40] Thus, DLSU's income from the leases of its real properties is not exempt from taxation even if the income would be used for educational purposes.^[41]

Second, the Commissioner insists that DLSU did not prove the fact of DST payment^[42] and that it is not qualified to use the *On-Line Electronic DST Imprinting Machine*, which is available only to certain classes of taxpayers under RR No. 9-2000.^[43]

Finally, the Commissioner objects to the admission of DLSU's supplemental offer of evidence. The belated submission of supplemental evidence reopened the case for trial, and worse, DLSU offered the supplemental evidence only after it received the unfavorable CTA Division's original decision.^[44] In any case, DLSU's submission of supplemental documentary evidence was unnecessary since its rental income was taxable regardless of its disposition.^[45]

G.R. No. 198841

DLSU argues as that:

First, RMO No. 43-90 prohibits the practice of issuing a LOA with any indication of *unverified prior years*. A LOA issued contrary to RMO No. 43-90 is void, thus, an assessment issued based on such defective LOA must also be void.^[46]

DLSU points out that the LOA issued to it covered the *Fiscal Year Ending 2003 and Unverified Prior Years*. On the basis of this defective LOA, the Commissioner assessed DLSU for deficiency income tax, VAT and DST for taxable years 2001, 2002 and 2003.^[47] DLSU objects to the CTA *En Banc*'s conclusion that the LOA is valid for taxable year 2003. According to DLSU, when RMO No. 43-90 provides that:

The practice of issuing [LOAs] covering audit of '*unverified prior years*' is hereby prohibited.

it refers to the LOA which has the format "*Base Year + Unverified Prior Years*." Since the LOA issued to DLSU follows this format, then any assessment arising from it must be *entirely* voided.^[48]

Second, DLSU invokes the principle of *uniformity in taxation*, which mandates that for similarly situated parties, the *same set of evidence* should be appreciated and weighed in the same manner.^[49] The CTA *En Banc* erred when it did not similarly appreciate

DLSU's evidence as it did to the pieces of evidence submitted by Ateneo, also a non-stock, non-profit educational institution.^[50]

G.R. No. 198941

The issues and arguments raised by the Commissioner in G.R. No. 198941 petition are *exactly the same* as those she raised in her: (1) petition docketed as G.R. No. 196596 and (2) comment on DLSU's petition docketed as G.R. No. 198841.^[51]

Counter-arguments

DLSU's Comment on G.R. No. 196596

First, DLSU questions the defective verification attached to the petition.^[52]

Second, DLSU stresses that Article XIV, Section 4 (3) of the Constitution is clear that *all assets and revenues* of non-stock, non-profit educational institutions used actually, directly and exclusively for educational purposes are exempt from taxes and duties.^[53]

On this point, DLSU explains that: (1) the tax exemption of nonstock, non-profit educational institutions is *novel* to the **1987 Constitution** and that Section 30 (H) of the **1997 Tax Code** cannot amend the **1987 Constitution**;^[54] (2) Section 30 of the 1997 Tax Code is almost an exact replica of Section 26 of the **1977 Tax Code** - with the addition of non-stock, non-profit educational institutions to the list of tax-exempt entities; and (3) that the **1977 Tax Code** was promulgated when the **1973 Constitution** was still in place.

DLSU elaborates that the tax exemption granted to a private educational institution under the 1973 Constitution was only for *real property tax*. Back then, the special tax treatment on *income* of private educational institutions only emanates from statute, *i.e.*, the 1977 Tax Code. Only under the 1987 Constitution that exemption from tax of all the *assets and revenues* of non-stock, non-profit educational institutions used actually, directly and exclusively for educational purposes, was expressly and categorically enshrined.^[55]

DLSU thus invokes the doctrine of constitutional supremacy, which renders any subsequent law that is contrary to the Constitution void and without any force and effect.^[56] Section 30 (H) of the 1997 Tax Code insofar as it subjects to tax the income of whatever kind and character of a nonstock and non-profit educational institution from any of its properties, real or personal, or from any of its activities conducted for profit *regardless of the disposition made of such income*, should be declared *without force and effect* in view of the constitutionally granted tax exemption on "all revenues and assets of non-stock, non-profit educational institutions used actually, directly, and exclusively for educational purposes."^[57]

DLSU further submits that it complies with the requirements enunciated in the *YMCA* case, that for an exemption to be granted under Article XIV, Section 4 (3) of the Constitution, the taxpayer must prove that: (1) it falls under the classification non-stock, non-profit educational institution; and (2) the income it seeks to be exempted from taxation is used actually, directly and exclusively for educational purposes.^[58] Unlike *YMCA*, which is *not* an educational institution, DLSU is undisputedly a non-stock, non-profit educational institution. It had also submitted evidence to prove that it actually, directly and exclusively used its income for educational purposes.^[59]

DLSU also cites the deliberations of the 1986 Constitutional Commission where they recognized that the tax exemption was granted "to incentivize private educational institutions to share with the State the responsibility of educating the youth."^[60]

Third, DLSU highlights that both the CTA *En Banc* and Division found that the bank that handled DLSU's loan and mortgage transactions had remitted to the BIR the DST through an imprinting machine, a method allowed under RR No. 15-2001.^[61] In any case, DLSU argues that it cannot be held liable for DST owing to the exemption granted under the Constitution.^[62]

Finally, DLSU underscores that the Commissioner, despite notice, did not oppose the formal offer of supplemental evidence. Because of the Commissioner's failure to timely object, she became bound by the results of the submission of such supplemental evidence.^[63]

The CIR's Comment on G.R. No. 198841

The Commissioner submits that DLSU is estopped from questioning the LOA's validity because it failed to raise this issue in both the administrative and judicial proceedings.^[64] That it was asked on crossexamination during the trial does not make it an issue that the CTA could resolve.^[65] The Commissioner also maintains that DLSU's rental income is not tax-exempt because an educational institution is only exempt from property tax but not from tax on the income earned from the property.^[66]

DLSU's Comment on G.R. No. 198941

DLSU puts forward the same counter-arguments discussed above.^[67]

In addition, DLSU prays that the Court award attorney's fees in its favor because it was constrained to unnecessarily retain the services of counsel in this separate petition.^[68]

Issues

Although the parties raised a number of issues, the Court shall decide only the pivotal issues, which we summarize as follows:

- I. Whether DLSU's income and revenues proved to have been used actually, directly and exclusively for educational purposes are exempt from duties and taxes;
- II. Whether the entire assessment should be voided because of the defective LOA;

III. Whether the CTA correctly admitted DLSU's supplemental pieces of evidence; and

IV. Whether the CTA's appreciation of the sufficiency of DLSU's evidence may be disturbed by the Court.

Our Ruling

As we explain in full below, we rule that:

I. The income, revenues and assets of non-stock, non-profit educational institutions proved to have been used actually, directly and exclusively for educational purposes are exempt from duties and taxes.

II. The LOA issued to DLSU is not entirely void. The assessment for taxable year 2003 is valid.

III. The CTA correctly admitted DLSU's formal offer of supplemental evidence; and

IV. The CTA's appreciation of evidence is conclusive unless the CTA is shown to have manifestly overlooked certain relevant facts not disputed by the parties and which, if properly considered, would justify a different conclusion.

The parties failed to convince the Court that the CTA overlooked or failed to consider relevant facts. We thus sustain the CTA *En Banc's* findings that:

a. DLSU proved that a portion of its rental income was used actually, directly and exclusively for educational purposes; and

b. DLSU proved the payment of the DST through its bank's on-line imprinting machine.

I. The revenues and assets of non-stock, non-profit educational institutions proved to have been used actually, directly, and exclusively for educational purposes are exempt from duties and taxes.

DLSU rests its case on Article XIV, Section 4 (3) of the 1987 Constitution, which reads:

(3) All revenues and assets of non-stock, non-profit educational institutions used actually, directly, and exclusively for educational purposes shall be exempt from taxes and duties. Upon the dissolution or cessation of the corporate existence of such institutions, their assets shall be disposed of in the manner provided by law. **Proprietary educational institutions**, including those cooperatively owned, **may likewise be entitled to such exemptions subject to the limitations provided by law** including restrictions on dividends and provisions for reinvestment [underscoring and emphasis supplied]

Before fully discussing the merits of the case, we observe that:

First, the constitutional provision refers to two kinds of educational institutions: (1) non-stock, non-profit educational institutions and (2) proprietary educational institutions.^[69]

Second, DLSU falls under the first category. Even the Commissioner admits the status of DLSU as a non-stock, non-profit educational institution.^[70]

Third, while DLSU's claim for tax exemption arises from and is based on the Constitution, the Constitution, in the same provision, also imposes certain conditions to avail of the exemption. We discuss below the import of the constitutional text vis-a-vis the Commissioner's counter-arguments.

Fourth, there is a marked distinction between the treatment of nonstock, non-profit educational institutions and proprietary educational institutions. The tax exemption granted to non-stock, non-profit educational institutions is conditioned only on the actual, direct and exclusive use of their revenues and assets for educational purposes. While tax exemptions may also be granted to proprietary educational institutions, these exemptions may be subject to limitations imposed by Congress.

As we explain below, the marked distinction between a non-stock, non-profit and a proprietary educational institution is crucial in determining the nature and extent of the tax exemption granted to non-stock, non-profit educational institutions.

The Commissioner opposes DLSU's claim for tax exemption on the basis of Section 30 (H) of the Tax Code. The relevant text reads:

The following organizations **shall not be taxed under this Title** [*Tax on Income*] in respect to income received by them as such:

xxxx

(H) A non-stock and non-profit educational institution

xxxx

Notwithstanding the provisions in the preceding paragraphs, the **income of whatever kind and character** of the foregoing organizations from any of their properties, real or personal, or **from any of their activities conducted for profit regardless of the disposition made of such income shall be subject to tax imposed under this Code**. [underscoring and emphasis supplied]

The Commissioner posits that the 1997 Tax Code qualified the tax exemption granted to non-stock, non-profit educational institutions such that the revenues and income they derived from their assets, or from any of their activities conducted for profit, are taxable *even if* these revenues and income are used for educational purposes.

Did the 1997 Tax Code qualify the tax exemption constitutionally-granted to non-stock, non-profit educational institutions?

We answer in the negative.